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No. 08-674

In the Supreme Court of the United States

NRG POWER MARKETING, LLC, ET AL., PETITIONERS

v.

MAINE PUBLIC UTILITIES COMMISSION, ET AL.

*ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT*

REPLY BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

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In the order at issue in this case, the Federal Energy Regulatory Commission (Commission or FERC) approved a comprehensive settlement of a long-running dispute concerning the structure of the market for electric generating capacity in New England. Section 4.C of the settlement provides that future challenges to certain rates established pursuant to the settlement will be governed by the "public interest" standard of review described in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956) (*Mobile*), and *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956) (*Sierra*). J.A. 95. The Commission reasonably exercised its discretion in approving the settlement, including the public-interest review provision of Section 4.C. The court of appeals erred in setting aside FERC's order, and its judgment should be reversed.

Petitioners criticize the reasoning of the court of appeals, while the non-FERC respondents attempt to defend the court's decision, but largely on grounds other than those on which it relied. Petitioners are correct in their ultimate conclusion that the judgment below should be reversed and FERC's order upheld. But neither petitioners nor respondents accurately describe what the Commission did in its order. And neither petitioners nor respondents focus on the central issue in this case, which is the reasonableness of the Commission's decision to approve the settlement, and, in so doing, to specify the manner in which it would carry out its statutory obligation to ensure just and reasonable rates. See 16 U.S.C. 824d, 824e.

Petitioners argue (Br. 47) that the rates covered by Section 4.C of the settlement agreement are the product of "contracts protected by *Mobile-Sierra*," so that Section 4.C "merely recited the standard that would apply in any event." That is incorrect. The rates to which Section 4.C applies—the results of the forward capacity auctions conducted under the settlement and the transition payments specified in the settlement—are generally applicable tariffs. They are not contract rates to which *Mobile* and *Sierra* would apply of their own force, and even if they were, the Commission could have required the settling parties to forgo the protections of *Mobile* and *Sierra* as a condition of its approval of the settlement. In other words, the public-interest standard is relevant to this case not because *Mobile* and *Sierra* are controlling, but only because the Commission made a discretionary decision to apply that standard.

Respondents, for their part, make an error in the opposite direction. Beginning with the correct premise that "the rates produced by the settlement are not 'con-

tract rates' to which the *Mobile-Sierra* presumption could apply," they assert that FERC lacked authority to "rewrite the terms of the" Federal Power Act (FPA), 16 U.S.C. 791a *et seq.*, and "abrogate the Respondents' statutory rights" by approving a settlement calling for application of the public-interest standard of review. Br. 11, 14. That reasoning is flawed because it overlooks that the underlying statutory requirement that rates be "just and reasonable," 16 U.S.C. 824d(a), does not compel the Commission to pursue any single regulatory approach. Respondents fail to appreciate that the "public interest standard" is not separate from—still less an "abrogat[ion]" of—the statutory just-and-reasonable standard, but is merely one way to implement that standard. See *Morgan Stanley Capital Group Inc.* v. *Public Util. Dist. No. 1*, 128 S. Ct. 2733, 2740 (2008) (*Morgan Stanley*).

Having carefully reviewed the settlement, the Commission determined that the auction mechanism would produce just and reasonable rates and that the transition payments were also just and reasonable. Based on those findings, and taking into account the interests in ensuring an adequate supply of generating capacity by promoting market stability, the Commission decided to approve the use of the public-interest standard as specified in Section 4.C. Significantly, although respondents essentially ignore the point, Section 4.C provides for application of the general just-and-reasonable standard—not the particular public-interest standard—to any future challenge to the rules that govern the conduct of the auctions, as well as to the rates produced by each auction during the 45 days after those rates are filed with the Commission. The Commission's approach, in all of these respects, was reasonable.

The foregoing reasons provide a sufficient basis for reversing the judgment of the court of appeals. But the court also erred in another respect, by holding that the application of the public-interest standard under *Mobile* and *Sierra* is limited to challenges brought by the contracting parties. That holding rests on a misunderstanding of *Mobile* and *Sierra*, and respondents' efforts to defend it are unavailing. If under *Mobile* and *Sierra*, the public-interest standard were statutorily mandated here—which it is not—then that standard would govern all challenges to the rates set by contract, regardless of the identity of the challenger.

A. The Commission Was Not Required To Approve The Settlement As A Whole Or Section 4.C In Particular

Section 4.C of the settlement provides that "the standard of review for: (i) challenges to the Capacity Clearing Prices derived through the [Forward Capacity Market] and * * * (ii) proposed changes to Section 11, Part VIII below (Agreements Regarding Transition Period) and the Market Rules implementing that part, shall be the 'public interest' standard of review" described in *Mobile* and *Sierra*. J.A. 95. Petitioners argue (Br. 47) that Section 4.C "merely recited the standard that would apply in any event." That is so, they say (*ibid.*), because "[t]he results of the capacity auctions are clearly contracts—voluntary agreements for the sale of capacity between sellers and buyers," and the transition payments "are likewise contract rates" because they "are expressly set forth in a contract" (*i.e.*, the settlement agreement).

Petitioners are correct that the Commission is required "to apply the *Mobile-Sierra* presumption in its evaluation of" rates set by contract. *Morgan Stanley*,

128 S. Ct. at 2745. But petitioners' characterization of the auction results and the transition payments as contract terms is not correct. Moreover, to the extent petitioners suggest that the Commission was required to approve Section 4.C, that is also incorrect: regardless of the nature of the rates covered by Section 4.C—that is, regardless whether they are properly viewed as contract rates or tariff rates—the Commission had the discretionary authority to approve or reject both the settlement of the proceeding as a whole and its provision for public-interest review of those rates.

1. Petitioners' argument that the auction results are contract rates rests on the general proposition that auctions result in contracts between the buyer and seller of the property auctioned. Petitioners refer to the usual auction setting, in which the ultimate agreement for sale of the property auctioned indeed has the hallmarks of a conventional contract. See, *e.g.*, *In re GWI PCS 1 Inc.*, 230 F.3d 788, 807 (5th Cir. 2000) ("General principles of auction law provide a baseline rule that the close of an auction—the fall of the hammer—signals acceptance of the offer and creates a binding contract between the seller and the high bidder."), cert. denied, 533 U.S. 964 (2001); *Lawrence Paper Co.* v. *Rosen & Co., Inc.*, 939 F.2d 376, 379 (6th Cir. 1991).

Contrary to petitioners' assertions (Br. 48-50), however, the forward capacity auction created by the settlement bears little resemblance to a conventional auction. The "demand" side of each annual auction is set not by the load-serving entities who will ultimately pay for capacity, but by the Independent System Operator (ISO) New England, which determines the estimated amount of capacity—known as the installed capacity requirement (ICR)—that the system as a whole will require for

reliability three years in the future. J.A. 121-123; see *Connecticut Dep't of Pub. Util. Control* v. *FERC*, 569 F.3d 477, 480 (D.C. Cir. 2009) (describing the auction mechanism), petition for cert. pending, No. 09-277 (filed Sept. 3, 2009). The ISO New England then announces the auction starting price, which is initially twice the estimated cost of new entry, and capacity providers state how much capacity they would be willing to offer at that price. J.A. 130-131. If capacity providers offer more capacity than required to meet the ICR, the ISO New England lowers the offering price using a "descending clock" process; that process in turn results in a lowering of the quantity of capacity offered until the quantity offered equals the ICR. J.A. 131-132. The ISO New England then assesses each utility in the system a capacity charge equal to the utility's share of the ICR multiplied by the market clearing price. *Connecticut Dep't of Pub. Util. Control*, 569 F.3d at 480.

Thus, the utilities "buying" capacity in the forward capacity market have no input into or role in the auction at all, and cannot be said to be "contracting" with the capacity sellers. Rather than agreeing to pay a specific seller an amount set by a voluntary bid for a particular property—as in a conventional auction—the "buyers" in the capacity auction are assessed a standard rate, based upon the intersection of the ICR set by the ISO New England and the offers made by the capacity sellers to provide capacity. While the bids of the capacity sellers commit them to supply the amount they offer at the clearing price, there are no "voluntary agreements" (Pet. Br. 49) of any sort between them and the buyers of the capacity provided. To the contrary, the standard capacity charge paid by each utility in the system for its share of the ICR is more akin to a conventional cost-

based tariff rate than to any voluntary agreement between that utility and a capacity seller.

2. Petitioners correctly point out (Br. 53) that "the transition-payment obligations *of the settling parties* are clearly 'contract rates'" because the settlement, once approved by the Commission, is at least in part a contract among the settling parties. As to the non-settling parties, petitioners say (Br. 54 n.15) that whether the transition-payment obligations are contract rates is a "complex question[]." But a contractual obligation can only arise from a promise, see Restatement (Second) of Contracts § 1 (1981), and therefore a non-settling party's obligation to make a transition payment—an obligation to which it has never agreed—cannot be said to be based on a contract. Instead, non-settling parties have an obligation to make transition payments because the Commission has approved the settlement prescribing those payments, which therefore are properly viewed as tariff rates.

According to petitioners (Br. 54 n.15), "the settlement does not in fact directly impose transition-payment obligations on non-parties," because the payments are actually made by the independent system operator. That is incorrect. The independent system operator calculates the amounts due and receives and processes the payments, but the payments are made by load-serving entities. Specifically, the settlement provides that transition "[p]ayments will be made to [unforced capacity] entitlement holders," that is, generators, "and made by [unforced capacity] obligation holders," that is, load-serving entities, of which respondent NSTAR Electric and Gas Corporation—an objector to the settlement—is one. J.A. 163; see J.A. 183 (defining "unforced capacity").

3. Finally, even if the auction results and transition payments were contract rates for any of the reasons petitioners offer, it would not follow that the Commission was required to approve Section 4.C of the settlement, which specifies that future challenges to those results and payments shall be governed by the public-interest standard. Petitioners appear to concede that, because the settlement was intended to resolve a contested proceeding before the Commission, the settlement could not become effective until the Commission reviewed it and determined that it was just and reasonable. Pet. Br. 12; J.A. 43; see *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 312-314 (1974); 18 C.F.R. 385.602(h). That approval required the exercise of independent judgment by the Commission. And it necessitated an assessment of the likely workings and effect of the settlement, including its auction mechanism and transition-payment framework, on all participants in the New England capacity market, including those who objected to the settlement. Thus, had the Commission believed that the overall settlement was not just and reasonable, it could have refused to approve it, or it could have approved it on the condition that it be modified in some way, such as by requiring that all future challenges to rates be subject to the ordinary just-and-reasonable standard of review.[*] For this reason as well, the FPA did not compel FERC to approve application of the public-interest standard to the rates at issue in this case.

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[*] Even in an ordinary contract situation, outside the context of a settlement, the parties may agree to a so-called "*Memphis* clause" specifying that the Commission may review future challenges to the rates under the ordinary just-and-reasonable standard. See *Morgan Stanley*, 128 S. Ct. at 2739; *United Gas Pipe Line Co.* v. *Memphis Light, Gas & Water Div.*, 358 U.S. 103 (1958).

B. The Commission Had Discretion To Approve The Settlement, Including Section 4.C

In approving Section 4.C of the settlement, the Commission specified the standard that it would apply in evaluating future complaints about the rates set by the capacity auctions or the transition payments fixed by the settlement. Those complaints would invoke FERC's authority under 16 U.S.C. 824e(a) to set aside rates that are "unjust, unreasonable, unduly discriminatory or preferential," as well as its authority under 16 U.S.C. 824d(a) to ensure that "[a]ll rates and charges * * * shall be just and reasonable." Accordingly, the Commission's approval of Section 4.C—including its provision for the public-interest standard of review—represented an interpretation of those provisions. That interpretation is a permissible construction of ambiguous statutory language, and respondents' challenges to it lack merit.

1. As an initial matter, respondents assert (Br. 37-38) that this Court should not consider "whether [FERC] has the power to impose the public interest standard as a matter of discretion" because FERC has raised the issue "for the first time in this Court." That suggestion is unfounded. In fact, the Commission has explained, at every stage of these proceedings, that its approval of Section 4.C represented an exercise of its interpretive discretion.

In its order approving the settlement, the Commission did not regard itself as compelled by *Mobile* and *Sierra* to apply the public-interest standard of review to the rates identified in Section 4.C. Instead, the Commission stated that it had "broad authority and discretion * * * to address contested settlements," Pet. App. 133a, and explained that it was approving the proposed settlement only after finding that the proposal was

"consistent with the public interest," *id.* at 135a, and "achieve[d] an overall just and reasonable result," *id.* at 141a-142a. With respect to Section 4.C in particular, the Commission did not say that application of the public-interest standard of review to future challenges to rates was required, but rather that it would be "fully consistent with current Commission policy." *Id.* at 201a; see *ibid.* ("[W]e find this *Mobile-Sierra* provision reasonable.").

Likewise, in its brief before the court of appeals, FERC argued that it had "reasonably exercised its discretion to accept the limited *Mobile-Sierra* provision in the Settlement." FERC C.A. Br. 22; see *id.* at 54 ("Reasonably exercising its discretion, the Commission rejected arguments that it revise or eliminate [Section 4.C], explaining that it is fully consistent with Commission policy, does not operate to the detriment of non-settling parties, and appropriately balances the need for rate stability with the legal requirement that rates be just and reasonable."). The court of appeals, as described earlier, did not consider the Commission's view that it had permissibly interpreted Sections 824d and 824e in approving the settlement.

According to respondents (Br. 37-38), because the court of appeals did not consider the Commission's discretion to specify an appropriate standard of review for rates not governed by *Mobile* and *Sierra*, this Court should not do so either. But since respondents have urged the Court to affirm the judgment below on the alternative ground that "the rates produced by the settlement are not 'contract rates' to which the *Mobile-Sierra* presumption could apply" (Br. 11), they can hardly ask the Court to ignore the question whether there is another basis for applying the public-interest

standard. Indeed, respondents' brief in opposition framed the question presented as "[w]hether the Commission may * * * approv[e] a settlement agreement that would require rate challenges brought by non-settling third parties to be evaluated under the * * * 'public interest' mode of review," Br. in Opp. i—a question that surely encompasses whether the Commission had discretion to prescribe that standard of review.

2. On the merits, respondents' argument rests (Br. 38) primarily on the assertion that "the Commission has no authority to vitiate the [Section 824e] rights of non-contracting parties." That is true, but it begs the question, because respondents do not explain how the application of the public-interest standard could "vitiate" their statutory rights. To the contrary, this Court has held that the public-interest standard is not "different from the statutory just-and-reasonable standard," but rather is only an application of it. *Morgan Stanley*, 128 S. Ct. at 2740. And the Commission recognized in its order that courts have "rejected the notion * * * that the public interest standard is 'practically insurmountable,'" so that "even under the 'public interest' standard of review, the Commission retains significant authority to protect non-parties to the settlement from harm." Pet. App. 202a (quoting *Northeast Utils. Serv. Co.* v. *FERC*, 55 F.3d 686, 691 (1st Cir. 1995)).

Similarly flawed is respondents' contention (Br. 39) that application of the public-interest standard "in a non-contract context would in effect ignore the plain language" of the FPA. The Act says only that rates must be "just and reasonable," and does not specify the manner in which that requirement will be implemented in any particular context. For that reason, this Court has held that the Commission is not "bound to any one

ratemaking formula" and that courts should "afford great deference to the Commission in its rate decisions." *Morgan Stanley*, 128 S. Ct. at 2738; see FERC Br. 24. Given the flexibility inherent in the just-and-reasonable standard, the Commission may require varying types and degrees of justification for the institution of or challenges to particular rates or practices, depending on the circumstances. When rates are set by contract, *Sierra* requires that the Commission apply the public-interest standard. But nothing in the FPA or in this Court's cases precludes the Commission from applying a similar standard of review to other rates as a matter of discretion, if considerations relevant to what is "just and reasonable" make that approach appropriate. Because "Congress has not directly addressed the precise question at issue" here—the standard of review that FERC must apply to future complaints about the capacity-auction results and the transition payments established by the settlement—FERC's interpretation of the just-and-reasonable standard must be upheld as long as it is reasonable. *Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837, 843 (1984). Nor can FERC be faulted for announcing in advance the methodology it will apply in considering future challenges to rates that are produced by the rate-setting methodology it has approved, to promote the interests of transparency and stability in the market.

3. Respondents also contend (Br. 39) that "FERC does not have discretion to establish rebuttable presumptions that form a barrier to [Section 824e] relief." But all FERC has done is to apply the public-interest standard, which this Court has held is required in some circumstances. In any event, the FPA does not prohibit FERC from using appropriate presumptions to guide its decisionmaking. Accordingly, courts have affirmed

FERC's adoption and application of evidentiary presumptions under the FPA and parallel provisions of the Natural Gas Act, 15 U.S.C. 717 *et seq.* See, *e.g.*, *Midcoast Interstate Transmission, Inc.* v. *FERC*, 198 F.3d 960, 970-972 (D.C. Cir. 2000); *East Tenn. Natural Gas Co.* v. *FERC*, 863 F.2d 932, 938 (D.C. Cir. 1988); *Associated Gas Distrib.* v. *FERC*, 824 F.2d 981, 1030-1037 (D.C. Cir. 1987), cert. denied, 485 U.S. 1006 (1988); cf. *Western Res., Inc.* v. *Surface Transp. Bd.*, 109 F.3d 782, 788 (D.C. Cir. 1997) ("The use of presumptions that capture reality in the general run of cases enables the Commission to do its work efficiently, and we have, on a number of occasions, approved its reliance on them."). And as explained below, the Commission's careful review of the settlement gave it ample reason to believe that the auction mechanism and the results it was designed to produce, as well as the transition payments, would be just and reasonable.

C. The Commission Acted Reasonably In Approving The Settlement

The Commission's approval of Section 4.C of the settlement represents a reasonable application of the FPA's requirement that rates be just and reasonable. Section 4.C is just one part of a larger settlement "contain[ing] several complex and interrelated features" that the Commission considered "as a package" and determined would "achieve[] an overall just and reasonable result." Pet. App. 140a-142a. In reaching that conclusion, the Commission found that the settlement would "provide[] the appropriate market structure to ensure that generating resources are appropriately compensated" and that it would "provide[] incentives to attract new infrastructure where needed." *Id.* at 142a. The

Commission emphasized that the settlement had attracted "broad-based support" and would resolve a "difficult, contentious proceeding." *Id.* at 143a. The Commission also made specific findings as to the justness and reasonableness of Section 4.C. *Id.* at 200a-203a. Respondents have not shown that any of those findings was not supported by substantial evidence or that the Commission's ultimate determination was arbitrary and capricious. See 16 U.S.C. 825*l*(b).

1. The Commission reasonably approved Section 4.C's application of the public-interest standard to any challenges brought, after an initial 45-day period, to the prices set by the forward capacity auctions created by the settlement. Even though those auctions result in tariff rates, not contracts between buyers and sellers, see pp. 5-7, *supra*, they nevertheless share with contracts certain market-based features that make the protection for market stability afforded by the public-interest standard appropriate.

Respondents argue (Br. 34) that FERC may not simply "presum[e] that contracts putatively reflecting market-based transactions naturally yield just and reasonable rates." But the Commission did not do so here. Instead, it carefully examined the design of the proposed auctions and determined that they would produce prices that are just and reasonable. See Pet. App. 142a ("[T]he key price-determining parameters of the [forward capacity market] descending clock auction * * * are appropriate and adequately supported in the record."); *id.* at 161a-193a (considering, and rejecting, objections to specific aspects of the auction design). Respondents make no effort to challenge those findings.

Significantly, moreover, the public-interest review provision of Section 4.C does not apply to "the market

rules that will be developed and filed with the Commission under the Settlement Agreement." Pet. App. 200a. Should any party develop grounds to contend that the auction rules are not producing just and reasonable prices, the Commission can alter the rules as appropriate, entirely unrestricted by Section 4.C. See *id.* at 78a.

The Commission also made sure that it will be able to monitor, on an ongoing basis, how the auctions work in practice, so that it will be in a position to modify the market rules if necessary and review the rates set under the auction each year. The settlement requires the ISO New England to make an informational filing with the Commission before each auction. Pet. App. 202a. It further requires the ISO New England to file the results of the auction with the Commission, after which they will be subject to challenge for 45 days. *Ibid.*; J.A. 118-119. Should any party believe that the results of an auction are not just and reasonable, it will be free to challenge them—unrestricted by Section 4.C—so long as it does so within that period. In light of those safeguards, the Commission reasonably concluded that, following the 45-day period, application of the public-interest standard to the results of the auction would be appropriate—especially since the rates set by an auction are in effect for a period of only one year, after which they will be reset by the rates determined in the next annual auction. All FERC has done is take the modest step of imposing a 45-day statute of limitations on bringing an ordinary just-and-reasonable challenge to the rates set by auction for the New England capacity market. The interests in repose and stability, which are critical for the smooth functioning of the auction mechanism, amply justify that limitation. And, of course, a load-serving utility may always choose to bypass the auction system

and acquire its assured capacity by bilateral contract, through the self-supply option the settlement agreement preserves. Pet. App. 112a-113a; see J.A. 84-85.

2. Section 4.C also applies the public-interest standard to future challenges to the payments prescribed in the settlement for the three-year transition period lasting until the auction-based capacity market becomes fully operational. As explained in FERC's opening brief (at 39), the Commission reviewed those payments and found them to be just and reasonable, and the court of appeals agreed. Pet. App. 144a-161a; *id.* at 8a-19a. Respondents do not contend that the likelihood of changed circumstances within the transition period was or is so great that revision of the rates would become appropriate. See J.A. 163. Having reviewed the transition payments at their inception, the Commission reasonably determined that a party seeking to be relieved from those payments should have to show that they were impairing the public interest. Respondents have made no effort to challenge the Commission's conclusion on that point.

3. One important factor that the Commission considered in deciding whether to apply the public-interest standard to the auction results and transition payments was the interest in encouraging investment by protecting industry stability. "Stability is particularly important in this case," the Commission found, because New England has suffered capacity shortages as a result "of the unstable nature of [capacity] revenues and the effect that has on generating units, particularly those who are critical to maintaining reliability." Pet. App. 202a; see *id.* at 78a-79a. As this Court has recognized, the public-interest standard of review is "a key source of stability." *Morgan Stanley*, 128 S. Ct. at 2749. In the context of

the auction results, certainty is important to suppliers of capacity, who must make immediate investments but will not actually deliver capacity at the rates set by the auctions until three years in the future. J.A. 62. Similarly, FERC noted that the transition payments "require a long-term commitment" from suppliers of capacity and "add certainty and price stability for load customers." Pet. App. 158a-160a.

Respondents argue (Br. 42) that concerns about stability in the New England capacity market are "overstated," but, as the court of appeals has elsewhere recognized, "[p]redictions regarding the actions of regulated entities are precisely the type of policy judgments that courts routinely and quite correctly leave to administrative agencies." *Public Utils. Comm'n* v. *FERC*, 24 F.3d 275, 281 (D.C. Cir. 1994); accord *FCC* v. *National Citizens Comm. for Broad.*, 436 U.S. 775, 813-814 (1978); see *Marsh* v. *Oregon Natural Res. Council*, 490 U.S. 360, 378 (1989) ("When specialists express conflicting views, an agency must have discretion to rely on the reasonable opinions of its own qualified experts even if, as an original matter, a court might find contrary views more persuasive.").

D. The Court Of Appeals Erred In Holding That The *Mobile-Sierra* Doctrine Is Inapplicable To Third-Party Challenges To Contract Rates And Terms

Separate and apart from declining to recognize the Commission's discretion to apply the public-interest standard to the transition payments and auction rates, the court of appeals also erred in limiting application of the public-interest standard under the (non-discretionary) *Mobile-Sierra* doctrine to challenges raised by contracting parties. According to the court, "the *Mobile-*

Sierra doctrine is designed to ensure contract stability *as between the contracting parties—i.e.* to make it more difficult for either party to shirk its contractual obligations." Pet. App. 24a. By contrast, "when a rate challenge is brought by a non-contracting third party," the court stated, "the *Mobile-Sierra* doctrine simply does not apply." *Id.* at 22a. In such a case, the court held, "the proper standard of review remains the 'just and reasonable' standard" of Section 824e. The court of appeals misunderstood *Mobile* and *Sierra*, and that error provides an independent basis for reversing the court's judgment. Respondents' efforts to defend the court's reasoning are unavailing.

1. As explained in FERC's opening brief (at 17-22), the court of appeals' interpretation of *Mobile* and *Sierra* was flawed for three reasons. First, the court failed to appreciate that the *Mobile-Sierra* doctrine rests on a "presum[ption] that the rate set out in a freely negotiated wholesale-energy contract meets the 'just and reasonable' requirement imposed by law." *Morgan Stanley*, 128 S. Ct. at 2737; see *Verizon Commc'ns Inc.* v. *FCC*, 535 U.S. 467, 479 (2002) (*Verizon Commc'ns*). In other words, the *Mobile-Sierra* presumption applies because of the process by which the rate was set—a freely negotiated contract—not because of the identity of the party challenging the rate.

Second, the essential point of the *Mobile-Sierra* public-interest standard is to allow the Commission to modify rates when doing so is necessary to protect third parties. See *Morgan Stanley*, 128 S. Ct. at 2746 ("[O]nly when the mutually agreed-upon contract rate seriously harms the consuming *public* may the Commission declare it not to be just and reasonable.") (emphasis added); see *Verizon Commc'ns*, 535 U.S. at 479. It there-

fore makes little sense to exclude challenges by "noncontracting third part[ies]," Pet. App. 22a, from the application of that standard.

Third, the rule adopted by the court of appeals would make the Commission's power to enforce Section 824e dependent upon the filing of a complaint by a third party. If, acting on its own motion, FERC initiated an investigation into a contract rate, it would be able to set aside the rate only if it found that the rate was harmful to the public interest. See *Papago Tribal Util. Auth.* v. *FERC*, 723 F.2d 950, 934 (D.C. Cir. 1983), cert. denied, 467 U.S. 1241 (1984). But if the Commission's investigation were triggered by a complaint filed by any person other than the contracting parties, the rate would be reviewed under the ordinary just-and-reasonable standard. Nothing in the FPA or this Court's cases suggests that the scope of the Commission's authority should be dependent on whether a complaint is filed.

2. Respondents attempt to defend the court of appeals' conclusion by arguing that "a prerequisite to the application of the *Mobile-Sierra* doctrine is a willing buyer and a willing seller." Br. 20 (capitalization modifed). That premise is correct, in that the *Mobile-Sierra* doctrine governs the review of rates set by contract, and the existence of a willing buyer and a willing seller is a prerequisite to the formation of a contract. But it does not follow that the limited public-interest standard of review under *Mobile-Sierra* applies only to later challenges brought by the buyer or the seller.

According to respondents, application of the public-interest standard is appropriate only with respect to parties who "*agree* to give up a right to challenge" contract rates. Br. 23; see *id.* at 22 ("[T]he *Mobile-Sierra* doctrine restricts the ability of a contracting party to

seek regulatory relief from the obligations to which it agreed in the contract."); *ibid*. ("*Mobile-Sierra* addresses the relationship between parties to a contract."). That reasoning repeats the error of the court of appeals, which believed that the function of *Mobile-Sierra* is "to make it more difficult for either party [to a contract] to shirk its contractual obligations." Pet. App. 24a. But this Court in *Morgan Stanley* emphatically rejected the proposition that *Mobile-Sierra* is "the equivalent of an estoppel doctrine." 128 S. Ct. at 2746 (citation omitted). *Morgan Stanley* held that *Mobile* and *Sierra* do not rest on the premise that the contracting parties are estopped from challenging a rate to which they have agreed, but rather on a "presum[ption] that the rate set out in a freely negotiated wholesale-energy contract meets the 'just and reasonable' requirement imposed by law." *Id.* at 2737. That presumption is unaffected by the identity of the person bringing the challenge.

3. Respondents assert (Br. 25-27), in support of the court of appeals' holding, that they are "directly" affected by the rates subject to the *Mobile-Sierra* clause at issue in the settlement. In their view (Br. 26), those rates effectively determine "the rates charged to the Respondents for wholesale service." But even if that claim is true, the court of appeals' decision is not limited to third parties who are "directly," as opposed to "indirectly," affected by a *Mobile-Sierra* contract. Instead, the court of appeals held as a categorical matter that *Mobile-Sierra* "simply does not apply" "when a rate challenge is brought by a non-contracting third party." Pet. App. 22a. That statement is incorrect.

In any event, the identity of respondents here provides an additional reason for the public-interest standard to apply to their challenges. Only respondent

NSTAR Electric and Gas Corporation is a wholesale purchaser of capacity. None of the other respondents participates directly in the New England capacity market. They are, rather, two coalitions of industrial consumers and a group of state officials, who presumably are interested in protecting retail customers who consume power from participants in the wholesale market. Under the framework of the FPA, state regulation of retail rates must take as a given the wholesale rates established under the FPA, whether by contract or by tariff. See, *e.g.*, *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986). It therefore would be contrary to the framework of the entire Act, not merely the *Mobile-Sierra* rule and *Morgan Stanley*, to allow a collateral attack on the wholesale contract rate by third-party retail customers under a standard different from the standard that applies when one of the contractual parties seeks to change the rate.

4. Finally, respondents suggest (Br. 32-33) that FERC has been inconsistent in its application of *Mobile-Sierra*. In its order, FERC acknowledged that, before 2002, it had not applied *Mobile-Sierra* to third-party challenges, but explained that it had changed its approach. Pet. App. 77a. Respondents do not argue that the change was procedurally defective or inadequately explained, nor could they plausibly do so. See generally *FCC* v. *Fox Television Stations, Inc.*, 129 S. Ct. 1800, 1810-1812 (2009).

Instead, respondents assert (Br. 32) that, even after 2002, "FERC's application of the *Mobile-Sierra* presumption to non-contracting third parties * * * has been far from uniform." That is incorrect. The cases they cite, *Milford Power Co., LLC*, 119 F.E.R.C. ¶ 61,167 (2007), and *Bridgeport Energy, LLC*,

118 F.E.R.C. ¶ 61,243 (2007), involved the ability of parties to bind the Commission to public-interest review of reliability-must-run (RMR) agreements. An RMR agreement entitles a generator to recover its full cost-of-service rate rather than the rate it could obtain on the open market. See *Blumenthal* v. *FERC*, 552 F.3d 875, 878 (D.C. Cir. 2009). Such agreements help to maintain reliable supply by keeping high-cost generators in operation, but they interfere with the efficient functioning of a competitive market. *Ibid.*

In *Bridgeport* and *Milford*, the Commission found that RMR agreements suppress market-clearing prices, deter investment in new generating capacity, and require many market participants to pay out-of-market prices for service, hindering market development and performance. *Bridgeport*, 118 F.E.R.C. at 62,193; *Milford*, 119 F.E.R.C. at 62,042; Pet. App. 215a; *id.* at 81a-82a. As a result, the Commission determined that RMR agreements should be used only as a last resort, and announced that it would not be bound by the public-interest standard in reviewing such agreements. *Bridgeport*, 118 F.E.R.C. at 62,193; *Milford*, 119 F.E.R.C. at 62,042. The decisions in *Milford* and *Bridgeport* turn on the market-disrupting effects of RMR agreements, not on any distinction between third-party challenges and other challenges. *Id.* at 62,042 n.47; *Bridgeport*, 118 F.E.R.C. at 62,193 n.30. Those decisions therefore have no relevance here.

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For the foregoing reasons and those stated in the opening brief, the judgment of the court of appeals should be reversed insofar as it granted the petitions for review.

Respectfully submitted.

ELENA KAGAN
Solicitor General

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